Raad van State

The Advisory Division's opinion on the 2023 Budget Memorandum and the 2022 September Report on Fiscal Monitoring

No.W06.22.0143/III/B 's-Gravenhage, 14 September 2022

In the Government Missive of 2 September 2022, No. 2022001746, Your Majesty, on the recommendation of the Minister of Finance, submitted the draft 2023 Budget Memorandum and 2022 September Report on Fiscal Monitoring to the Advisory Division of the Council of State for consideration, with an explanatory memorandum.

A. INTRODUCTION AND CONCLUSION

1. Introduction

In this report the Advisory Division of the Council of State publishes its opinion on the 2023 Budget Memorandum and the report related to independent fiscal monitoring.

Both the report related to fiscal monitoring and the opinion on the Budget Memorandum stem from the Sustainable Public Finances Act (Wet Houdbare Overheidsfinanciën, 'Wet HOF'). The government responds to the opinion on the Budget Memorandum in a subsequent report sent to the House of Representatives at the same time as the opinion on the Budget Memorandum.

In 2022, in the context of independent fiscal monitoring, the Advisory Division prepared three reports, one in April, June and September.[1] In the reports the Advisory Division provides an assessment of the expected budgetary developments and intentions as adopted by the government in, respectively, the Stability Programme, the Spring Memorandum and the Budget Memorandum. The government's response to the September Report on fiscal monitoring is included in full in this report.

In its assessment the Advisory Division works closely with the CPB Netherlands Bureau for Economic Policy Analysis. The division of tasks entails that the drawing up of independent economic and budgetary forecasts and analyses are assigned to the CPB Netherlands Bureau for Economic Policy Analysis; the Advisory Division assesses compliance with (European and national) fiscal rules.

In the interests of quality and meticulousness in drawing up the assessment,

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[1] In addition, in January 2022, the Advisory Division sent a letter containing recommendations on the government's budgetary policy to the Minister of Finance (Parliamentary Documents II 2021/22, 35788, No. C).

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for the September Report and the opinion on the Budget Memorandum the Advisory Division was able to consult a draft version of the 2023 Budget Memorandum.

This report is structured as follows:

2. <u>Summary conclusion and advice</u>

On Budget Day, the government presents its first Budget Memorandum. The Budget Memorandum comes at a time when the economic picture is determined by high inflation and great uncertainty. Concurrently, the economy continues to display strong growth this year, and will continue to do so next year too, even though it will be less vigorous. Meanwhile, public finances still look positive, due mainly to temporary factors. In the longer term, an ageing population and the climate and energy crisis will have a detrimental effect on public finances.

The mixed outlook of the economy and public finances calls for an analysis of the Netherlands' socio-economic structure and the underlying medium-term strengths and weaknesses. The Advisory Division recommends this analysis be part of the Reform Programme that the government prepares annually in the spring as part of the European Semester. The aim of such an analysis is to arrive at integrally considered choices and priorities, and thus to support the government and parliament's capacity to act and solve problems. This is needed now more than ever because not everything is possible, and certainly not at the same time. This is demonstrated on a daily basis by deadlocked implementing organisations and is also evident from a number of measures announced in the 2023 Tax Package.

The fact that not everything is possible is partly due to the historically tight labour market. This labour market tightness has significant economic and social implications. The Advisory Division sees that the government is taking steps to address the labour market tightness, but calls on the government to address the long-term bottlenecks on the labour market more expeditiously. The Advisory Division also advises the government to take labour market effects into account in new proposed policies. In addition, the Advisory Division sees starting points to contribute to a solution to the tightness, by making it more interesting for employees to work more hours. Both the government and employers have a role to play in this matter.

The government has changed the budgetary process, and this year launched a multi-year Spring Memorandum so that parliament is involved earlier in budgetary decision-making regarding both the expenditure and tax side. Moreover, as of this year, not only the main points of the expenditure side of the budget are decided in the spring, but also those on the tax side.

In the August decision-making process, as a result of the unprecedented estimated decline in purchasing power, the decision was taken to implement a comprehensive package of measures to support purchasing power. Because this package was decided in a very short time frame, the consequences of the choices made in the August decision-making process are hard to oversee, whereas the new budgetary process aims to bring more calm and promote integral decision-making.

The Advisory Division understands the exceptional circumstances in which the government is operating with regard to the development of purchasing power. However, the rushed process in August not only stands in the way of careful decision-making on other issues, such as wealth distribution, but does not advance the feasibility of measures for citizens and businesses either. Therefore, the Advisory Division's advice to the government, as well as to the House of Representatives and the Senate is to adhere to the procedural agreements that apply to the new-style Spring Memorandum.

In the assessment under European fiscal rules, the Advisory Division concludes that while the Netherlands does comply with the rules in the corrective arm of the Stability and Growth Pact (SGP) for 2022 and 2023, it does not comply with the rules in the preventive arm for both years. Due to the currently active general escape clause, the overshoots in the preventive arm of the SGP have no consequences.

In the 2022 Spring Memorandum the government states that the limit of expenditure the government considers acceptable has been reached and that in principle, new policy that had consequences for the budget will have to be covered. However, the 2023 Budget Memorandum policy package again leads to further uncovered intensifications in the short term. Due to the improvement in the EMU balance and debt compared to the CEP due to temporary factors, this does not lead to major consequences for now. However, these overshoots mean that the government is not abiding by its own national fiscal rules.

The Advisory Division also concludes that the assessment under national fiscal rules is incomplete. Due to the delay in political decision-making and the many reviews and ceiling adjustments due to new policies, the CPB Netherlands Bureau for Economic Policy Analysis was unable to conduct ceiling assessments with regard to the August decision-making process. The Advisory Division deems this a worrying development. An orderly budgetary process is in the interest of democracy, to provide independent insight into the impact of government policies on society, the economy and the budget. Also in exceptional situations.

On a positive note, the government addresses both financial sustainability and the sustainability of public finances for future generations in the 2023 Budget Memorandum. The government has also taken further steps in anchoring broad prosperity in the budget cycle and the transparent presentation of budget-relevant topics.

B. MACROECONOMIC AND BUDGETARY CONTEXT

1. The macroeconomic outlook

The Dutch economy is showing strong recovery following the Covid-19 crisis, also from an international perspective. High growth in the second quarter of 2022, and spillover growth at the end of 2021 is expected to result in a high growth rate of 4.6% of GDP in 2022, according to the CPB Netherlands Bureau for Economic Policy Analysis.[2] During the remaining quarters of 2022, the outlook is expected to change, partly due to the aftermath of the Covid-19 crisis and the war in Ukraine. Prices, especially of energy, certain commodities and food, have risen sharply. In the Macroeconomic Outlook (MEV), the CPB expects, due to high inflation of 9.9% in 2022 combined with a negligible increase in wages, an average decrease in purchasing power of 6.8% in 2022. Lower incomes are hit harder by high energy prices. This inflation inequality is not reflected in the picture of purchasing power. The CPB estimates that the number of people living below the poverty line is rising sharply. In 2022, 6.7% of the Dutch population is expected to live below the poverty line, including 9.2% of all children.

The growth forecast for 2023, at 1.5% of GDP, is significantly lower than in 2022. However, this is not of immediate concern, as expected growth is 0.3 percentage points above potential growth. The rate of unemployment continues to be extremely low: it remains below 400,000 this year and next, compared to over 450,000 vacancies in the second quarter of 2022.

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[2] CPB Netherlands Bureau for Economic Policy Analysis (2022). 2023 Macroeconomic Outlook (MEV).

Table 1: Key figures of macroeconomic developments

	2021	2022		2023	
(changes in % per annum)	**MEO 2023**	***CEP 2022***	**MEO 2023**	***CEP 2022***	**MEO 2023**
Eurozone					
Gross domestic product (economic growth)	5.4	*4*	3.2	*2.4*	1.3
The Netherlands					
Gross domestic product (economic growth)	4.9	*3.6*	4.6	*1.7*	1.5
Gross investments by companies (excl. Housing %)	4.8	*3.1*	4.5	*3.3*	0.5
Investments by companies in housing	3.3	*5.6*	2	*2.6*	1.1
Household consumption	3.6	*4.7*	5.7	*1.5*	1.8
Static purchasing power	0.3	*-2.7*	-6.8	*1.9*	3.9
Inflation, national consumer price index	2.7	*5.2*	9.9	*2.4*	2.6
Persons in poverty	5.7	*x*	6.7	*x*	4.9
Imports of goods and services	4.0	*5.5*	2.8	*5.5*	3.9
Exports of goods and services	5.2	*4.9*	4	*4.3*	3.2
Employment (in hours)	3.3	*2.9*	5.2	*0.9*	0.5
Unemployed working population (level in %)	4.2	*4*	3.4	*4.3*	3.9

Source: CPB, 2023 Macroeconomic Outlook (MEV), 2022 Central Economic Plan

On the other hand, consumption growth is under pressure, due to high inflation and the corresponding uncertainty. Despite the tight labour market, with the exception of a few recent examples, the increase in wages is remarkably limited. As a result, wages are expected to lag behind core inflation (inflation minus energy and food prices). According to the CPB, economic growth in 2023 is thus mainly driven by exports and government consumption.

Analyses by the CPB and De Nederlandsche Bank (Dutch Central Bank (DNB) show that there is currently scope for wage increases, although this will vary according to the sector.[3] Following high household consumption growth of 5.7% in 2022, household consumption growth in 2023 is significantly lower at 1.8%. The number of people living below the poverty line is expected to fall to 4.9% of the Dutch population in 2023 and to 6.7% of all children compared to 2022, partly due to the measures taken by the government in the 2023 Budget Memorandum.

[3] CPB Netherlands Bureau for Economic Policy Analysis (2022). 2023 Draft Macroeconomic Outlook (MEV). CPB forecast August 2022. De Nederlandsche Bank (Dutch Central Bank (DNB)) (2022). Economic Developments and Outlooks. June 2022.

As far as companies are concerned, the picture is also mixed. While many sectors are in good to very good shape in terms of order books and profitability, others are in a less rosy state due to rising costs, falling consumption and repayment obligations due to tax deferrals because of Covid-19. Almost all sectors are suffering from the tight labour market.

There is still considerable uncertainty with regard to economic developments. The course of the war in Ukraine has a major impact, the open Dutch economy is sensitive to disruptions in global trade and the global economy. Other downside risks to economic growth include the threat of another wave of Covid-19, rising and persistent inflation, the 'gas and energy crisis' and possibly the further widening of interest rate differentials in the eurozone.

Bearing these risks in mind, and given the moderate growth, several quarters of negative growth (a technical recession) is not unlikely. However, according to the CPB, its significance should not be overestimated; for instance, the tight labour market makes a rapid rise in unemployment unlikely.

2. The budgetary outlook

Public finances look more positive than estimated earlier this year, due mainly to temporary factors. Government revenues are benefiting from robust profit tax revenues following the recovery from the Covid-19 crisis. In addition, the high gas prices also lead to substantially higher gas revenues. Since not all public investments can be achieved, public expenditure increases less than budgeted. However, the purchasing power package announced in the 2023 Budget Memorandum leads to a deterioration of the EMU balance in 2023, which is expected to reach -2.5% of GDP. In contrast, the debt ratio is subject to a positive development, partly due to inflation (the 'denominator effect'), and is expected to reach 48.8% of GDP in 2023.

Table 2: Key public finances figures[a]

(in % of GDP)		2019	2020	2021	2022	2023
Gross general expenditure		42.4	48.4	47	45.7	45.7
General government revenue		39.3	39.7	39.7	39.2	38.2
Actual EMU balance		1.7	-4.2	-2.6	-1.1	-2.5
of which	*EMU balance for local governments*	-0.3	-0.3	0.2	0.2	-0.1
Structural EMU balance		0.8	-1.9	-1.8	-1.7	-3
Government debt		48.5	54.3	52.4	49.6	48.8

Source: CPB (Macroeconomic Outlook (MEV) 2022 and Macroeconomic Outlook (MEV) 2023)

[a] 2019 and 2020 figures: Macroeconomic Outlook (MEV) 2022. Other figures are taken from the Macroeconomic Outlook (MEV) 2023

Since there is significant economic uncertainty, the development of public finances is also uncertain. Not all planned government spending will be realised. A substantial part of planned government intensification cannot be achieved due to supply problems and persistent labour market tightness. The debt ratio could rise again quickly in the event of economic setbacks. What's more, the expected increase in interest rates in 2022 and 2023 leads to a budgetary task that, according to budgetary rules, has to be accommodated under the expenditure ceiling, reducing the budgetary scope for other tasks.

C. OPINION ON THE 2023 BUDGET MEMORANDUM

The Rutte IV government took office on 10 January 2022. Since then, the Initial Policy Memorandum appeared, the budgetary elaboration of the Coalition Agreement[4] and the new-style Spring Memorandum: multi-year and containing as much budgetary decision-making as possible for 2023.[5] Now, we have the new government's first Budget Memorandum. The 2023 Budget Memorandum presents the full 2023 budget, with the macroeconomic impact of the budget based as usual on forecasts from the CPB's Macroeconomic Outlook (MEV).

As outlined in Section B, the multi-year economic outlook is not only uncertain but also difficult to interpret.

Bearing this in mind, the government has freed up almost €16 billion to mitigate the historic decline in purchasing power. This package of measures partly targets lower incomes. In addition, the government calls on employers to allow wages to

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4 The Rutte IV Government Initial Policy Memorandum, Parliamentary Documents II 2021/22, 35925, No. 143

5 2022 Spring Memorandum, Parliamentary Documents II 2021/22, 36120, No. 1

rise, to facilitate the structural recovery of purchasing power. Moreover, the government has taken the first steps to make the taxation on labour and capital more balanced. Part of the proceeds will be used to reduce the burden on labour through a reduction in employers' charges.

Public finances not an obstacle in the short term

Dutch public finances are in relatively good shape, especially from a European perspective. However, this positive picture is mainly due to temporary factors, such as underspending, higher profit tax income and higher gas revenues. The debt ratio is considerably lower than estimated earlier this year due to the inflationary denominator effect.

The Budget Memorandum rightly devotes attention to public finances in the longer term, partly based on the CPB's debt sustainability analyses. This not only serves the sustainability of the Netherlands' debt, but above all a fair distribution of burdens between generations, now and later on. Not only the ageing population (mainly due to an increase in public healthcare spending and the state pension), but also the climate and energy crises will test the robustness of our public finances in the coming decades. Moreover, the fragility of public finances in the long term is at least as worrying in many other eurozone Member States, as the Budget Memorandum rightly analyses. This could potentially have an impact on the stability of the eurozone as a whole.

Therefore: look beyond daily rates with a structural analysis

The mixed, difficult to interpret outlook of the business cycle calls for an analysis of the socio-economic structure of the Netherlands and its underlying strengths and weaknesses in the medium term.

The Budget Memorandum illustrates, almost in passing, the importance of structural policy over cyclical policy. The comparison, in Section 1.1.2 with the energy and inflation crises of the 1970s leads to the conclusion that *"[this] policy [of purchasing power restoration and higher government spending] was of little use, as the driven demand pushed prices up further. A better solution [...] was to focus less on compensation and more on structural reforms to promote growth."* Section 1.2.4 of the Budget Memorandum argues that fiscal policy can only partially absorb shocks, and that a well-functioning labour and production market and well-functioning financial markets are important for an economy's capacity to adjust.

Traditionally, the Budget Memorandum, and certainly the first of a newly appointed government, constitutes the perfect opportunity for such a socio-economic structural analysis. It also includes building blocks for choices for the entire government term. This draft Budget Memorandum largely lacks such a coherent consideration. This is a shortcoming, not only because of the observations from the Budget Memorandum quoted above, but also for other reasons.

Because, as Drees sr. noted: not everything is possible and certainly not at the same time

A good structural analysis in conjunction with fiscal and budgetary policy can help promote integral decision-making and setting priorities during a government term. In other words, it supports the government and parliament's capacity to act and solve problems, so that measures that are deemed more necessary are actually feasible. This is needed now more than ever.

The Coalition Agreement identifies major social challenges. Meanwhile, the 29 ministers have sent dozens of outline papers related to individual policy areas to parliament, in addition to just as many other letters to parliament on individual policies. The (outline) papers set out the direction for the individual policy areas and the extent to which they are considered in conjunction with one another is limited. However, it is precisely the connection between the major challenges that constitutes the complicated puzzle facing the government, parliament and Dutch society in the coming years. Policy choices are interrelated and interdependent. This concerns, for example, choices about our spatial planning: the housing challenge cannot be separated from the climate and energy transition, nature restoration, infrastructure, and our healthcare system. Solving labour market bottlenecks is a precondition for actually being able to implement these tasks. This also applies to healthcare, childcare and education.

The fact that not everything is possible, and certainly not at the same time, is demonstrated on a daily basis by deadlocked implementing organisations. The public service provision and implementation capacity of both central and local government is currently under serious pressure. The labour market in the public administration, security, healthcare and welfare sectors is extremely tight.[6] The greatest staff shortages are in ICT-related occupations, for which expertise is also in high demand in the public sector. In 2021, there were difficulties filling one in five vacancies in municipalities, putting pressure on municipal services.[7] Work in implementing organisations has been under pressure for some time.

As early as 2020, it was observed that the limits for diverse implementing organisations have been reached in terms of capacity to meet the expectations of citizens, social institutions, businesses and policy.[8] This is exacerbated by current labour market shortages. The Tax and Customs Administration, the UWV, COA

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[6] UWV (2022). Tightness Indicator Dashboard https://www.werk.nl/arbeidsmarktinformatie/dashboards/spanningsindicator

[7] Stichting Arbeidsmarkt en Opleidingsfonds Gemeenten (Municipalities Labour Market and Training Fund Foundation) (2022). Municipalities Staff Monitor 2021.

[8] Parliamentary Documents II 2021/22, 29361, No. 290.

and DJI, among others, recently expressed difficulty in attracting new employees. As a result, they are forced to adjust or prioritise their processes.[9]

The House of Representatives called for additional measures to improve household purchasing power during the debate on the 2022 Spring Memorandum. In response, the government examined various options related to feasibility, budgetary implications and reaching the most vulnerable households.[10] This study revealed that there are no measures feasible in the short term or that do not pose major risks to existing schemes.

The government argued that while some individual measures seem feasible at first glance, the accumulation of implementing burdens and interim changes in policy increase the risk of errors. At the same time, the question of whether policies should be continued in their current form or be revised is almost never asked or answered. This is also stated by the Netherlands Court of Audit in a report on the 'Insight into Quality' operation.[11] The Netherlands Court of Audit recommends that all evaluations and policy audits should explicitly question whether a fundamental revision of policies is needed or whether it would be better to end policies.

Making choices is inevitable when faced with a large number of social challenges in conjunction with major bottlenecks in implementation. The fact that not everything is possible is also evident from a number of measures announced in the 2023 Tax Package.[12] The 2023 Budget Memorandum acknowledges that the Tax and Customs Administration is struggling with the emerging complexity of implementation, which means that necessary improvements have to be regularly postponed.

As far as the Advisory Division is concerned, an analysis of the coherence of the major challenges and of the more structural and longer-term developments in society and the economy explicitly aims to arrive at integral decision-making and prioritisation, thereby supporting the government's capacity to come up with solutions. This is to ensure that at least the most urgent matters can actually be carried out (in a timely manner).

An explanation of the different components of economic growth, the strengths and weaknesses of our economy and the groups that have benefited from the growth should be part of this analysis. Bearing this in mind, it is important that a

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9 NOS (2022). Staff shortages at implementing organisations such as UWV, Tax and Customs Administration and IND. https://nos.nl/artikel/2439867-ook-personeelstekorten-bij-uitvoeringsorganisaties-als-uwv-fiscus-en-ind and NOS (2022). COA on the verge of collapse with above average absenteeism. https://nos.nl/collectie/13898/artikel/2438681-coa-staat-op-instorten-bovengemiddeld-veel-verzuim

10 Parliamentary Documents II 2021/22, Letter to Parliament following up on the Spring Memorandum debate. Inventory of possible purchasing power measures 2022, July 2022.

11 Netherlands Court of Audit (2021). Insight into quality. Operation successful?

12 See also the Advisory Division's opinion on the 2023 Tax Plan.

socio-economic structural analysis focuses on the full breadth of the economy, public, social and private sectors.

It is understandable that a Budget Memorandum, which deals with the state budget and public policy, devotes a lot of attention to the public sector. But this is only part of the reality. One should constantly bear in mind that without a healthy private sector with enough workers, there are insufficient tax resources to pay for public spending, and that most of the workers and society are involved in the private sector.

Traditionally, the Budget Memorandum is considered the right medium for such an analysis because Dutch fiscal rules, with frameworks for the expenditure and tax side, help achieve coherence in policy and with implementation, and to safeguard the balance between choosing for the present and the future. Financial instruments provide insight into considerations, prioritisation, dependencies and the effectiveness of government policies as a whole. And thus into the benefits and costs for citizens, businesses and civil society organisations, the taxpayers.

So: analyse and make decisions so that urgent matters can indeed be dealt with

The Advisory Division recommends bundling the aforementioned individual sections from the Budget Memorandum and building blocks from the many (outline) papers into a coherent socio-economic structural analysis. This can also address the implications for long-term reforms and policies, including in the European context. It could include the starting points that, despite the lack of an overarching consideration, the 2023 Budget Memorandum does provide, for example, on the seven themes of broad prosperity mentioned.

The Advisory Division recommends making this analysis part of the Reform Programme that the government prepares annually in the spring as part of the European Semester. On an annual basis, this programme addresses the state of the economy, socio-economic issues and reforms in light of country-specific recommendations, proposed annually by the European Commission and adopted by the Council, and European priorities such as green, social and digital.

Strengthening the coherence between the Reform Programme, the Stability Programme[13] and the new-style Spring Memorandum (see also Section E1) at the same time will kill several birds with one stone.[14] Besides the main purpose of such an analysis - to reinforce long-term priorities so that matters are dealt with - it also makes the Stability and Reform Programmes more substantive, more

[13] The Stability Programme serves as a national medium-term budgetary plan and is part of the European Semester. Member States in the eurozone are required to submit annual Stability Programmes to the European Commission.

[14] In the 2022 June Report, the Advisory Division recommended the cohesion between the Stability Programme and the Reform Programme be enhanced with national fiscal policy and socio-economic policy.

politically interesting and fulfils the ambition to make the new-style Spring Memorandum more important, also for parliament.

The Advisory Division provides three starting points for such an analysis in the next Reform Programme, in conjunction with the Spring Memorandum.

Firstly, the European Union. It is notable that the EU is only mentioned in the Budget Memorandum (Section 1.2.4) in the context of public finances.[15] While a large part of economic (structural) policy has long been shaped in Brussels. As a result, European policies have decisive economic significance for individual Member States, for example, in the areas of climate, energy, digitisation, taxation, the capital and banking union and state aid. Hence the advice to establish a connection with the annual Reform Programme.

Secondly, broad prosperity. Broad prosperity is about the 'here and now', but also about 'elsewhere' and 'later'. Steering in terms of broad prosperity thus also means steering for the medium and long term. The 2023 Budget Memorandum states that future prosperity is under greater pressure than current prosperity. The government aims to anchor broad prosperity more effectively in the budget cycle. This brings steering in terms of broad prosperity one step closer. The draft Budget Memorandum continues this trend; the Advisory Division is positive in this regard. Indeed, the aforementioned seven themes on broad prosperity can be viewed as the start of a socio-economic structural analysis.

To increase broad prosperity in the Netherlands, the government has identified seven priorities in the field of broad prosperity, which will be considered annually in the Budget Memorandum. Further anchoring broad prosperity in the budget system is achieved by including the insights of the assessment agencies when developing the core set of broad prosperity indicators in the Budget Memorandum. The core set will look ahead and focus on the trade-off and complementarity of broad prosperity objectives.[16] The ambition of the assessment agencies is to be able to carry out broad prosperity analysis on proposed policies.[17] Thus enabling the establishment of a relationship between government policies and future broad prosperity. Eventually, the core set is expected to consist of eight themes with about fifteen indicators.[18]

The Advisory Division notes that it is subsequently up to the government and parliament to determine which indicators they will primarily focus on. It is good to further develop and use the comprehensive set of broad prosperity indicators,

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[15] A reference to the Dutch recovery and resilience plan is also missing, as well as a reference to the joint European plan to become independent of Russian fossil fuels (REPowerEU).

[16] CPB Netherlands Bureau for Economic Policy Analysis (2022). Brede welvaart: het CPB voorbij het bbp (Broad prosperity: the CPB beyond GDP.) CPB memorandum.

[17] CPB, PBL and SCP (2022). Anchoring broad prosperity in the budget system. Progress report of the three joint assessment agencies.

[18] Parliamentary Documents II 2021/22, 34298, No. 37

from the CBS and the assessment agencies, also in budget debates. But more meters on the dashboard of the Ship of State does not necessarily make navigation easier. Therefore, it recommends using these broad prosperity indicators to mainly steer from the longer-term perspective; not looking at daily rates but at multi-year trends.

The recent CPB forecast of the evolution of poverty[19] is one example of how including a broad prosperity indicator in the budget debate adds an extra consideration to the discussion and allows more direct steering in terms of the elements of broad prosperity. The Interdepartmental Policy Research (IBO) on wealth distribution also offers starting points for steering in terms of broad prosperity.[20]

Steering in terms of broad prosperity in the long term also extends the policy horizon, among other things. Explicitly and implicitly, the current Dutch policy cycle assumes four-year parliamentary and government cycles. Major social challenges do not relate to a four-year perspective. Therefore, the Advisory Division suggests that the announced, core set of broad prosperity indicators to be developed focus on (at least) 2030 and 2050, laying a foundation for a longer-term (policy) cycle. The opinion to be issued by the end of 2023 by the recently established State Commission on Demographic Developments 2050 may also be helpful in this regard.

Thirdly, quality of public expenditure. As public finances are in relatively good shape, there do not seem to be any quantitative constraints. Thus, the debt ratio is expected to continue to hover around 50% of GDP in the coming years - well below the European target for public debt of 60% of GDP.[21] If financial resources do not seem to be a constraint, there is a risk of not paying attention to the quality of expenditure. But there is no such thing as free money: compensation for one is a tax for another, now or in the future.[22] Thus, it is important to weigh up each time whether an additional expense or tax relief is effective and efficient and who benefits: current or future generations.

The government has included a reflection on the role of the market and of the government in the 2023 Budget Memorandum, which seems to provide direction for policy. In it, the government argues that it should not compensate without major trade-offs. At the same time, the government plans to extend the reduction in fuel excise duty introduced in 2022 until July 2023, after which the reduction will be halved for the rest of 2023. The Advisory Division previously concluded

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[19] CPB Netherlands Bureau for Economic Policy Analysis (2022). 2023 Draft Macroeconomic Outlook (MEV). CPB forecast August 2022.

[20] Interdepartmental Policy Research (IBO) (2022). Lights off, Focus on Wealth Distribution.

[21] However, many uncertainties do exist around the forecasts (see also Section B of this report).

[22] CPB Netherlands Bureau for Economic Policy Analysis (2022). The compensation society is not going to work. CPB Column 25 March 2022.

that this measure is highly untargeted and has a serious budgetary impact. The measure also goes against the government's climate ambitions.[23]

The government has several tools at its disposal to achieve policies that are better motivated. Besides the reports and opinions of the Netherlands Court of Audit, Interdepartmental Policy Research (IBOs) are also constantly proving their worth. The same applies to social cost-benefit analyses for proposed investments whether or not from, or combined with, independent advisory committees. It remains equally important to continuously maintain the design and infrastructure of the State budget and the departmental finance function. The Advisory Division underlines the importance of the Minister of Finance's intentions in this regard.[24]

D. LABOUR MARKET

There is currently a major and urgent tightness in the labour market. This labour market tightness has significant economic and social implications.

It is affecting both private and public sectors. Labour market shortages threaten prosperity in the broad sense, as well as essential public goods and services in areas such as healthcare and law enforcement. A sufficient workforce is a prerequisite for making progress in solving other pressing social challenges and crises, such as the climate transition, nitrogen problem and housing market shortages.

There are currently more vacancies than jobseekers: in the second quarter of 2022, 3.3% of the working population was unemployed, which is very low both internationally and historically. In the second quarter of 2022, 466,888 vacancies were open and the number of unemployed in the working population fell to 327,000. This amounts to 143 vacancies for every 100 unemployed.[25]

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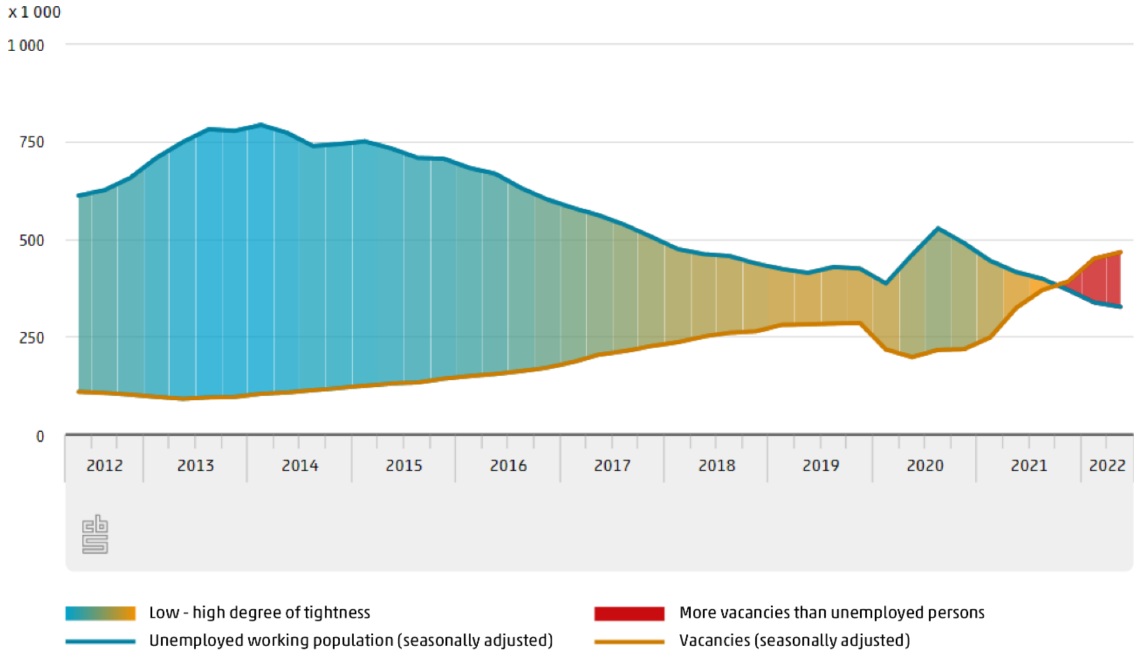
[23] April Report 2022, Parliamentary Documents II 21501-07, No. 1840, W06.22.0055/III
[24] See the 2022 Draft Budget Memorandum, Annex 14: improving information provision in and around budgets.
[25] Statistics Netherlands (CBS) (2022). Tightness in the labour market dashboard.

Figure 1: vacancies and unemployed working population

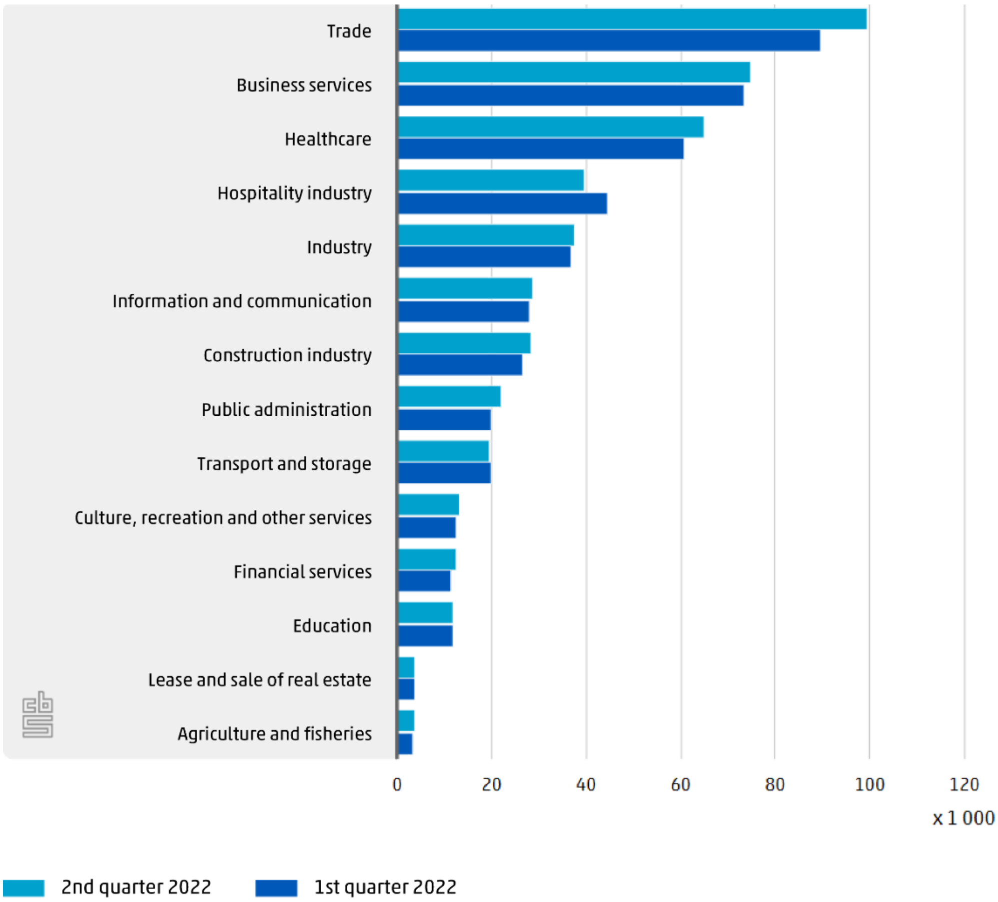


Source: CBS

Most vacancies in the second quarter of 2022 were open in trade (100,000), business services (75,000) and healthcare (65,000). Collectively, these three sectors account for half of all vacancies.[26]

[26] Statistics Netherlands (CBS) (2022). Tightness in the labour market continues to rise. https://www.cbs.nl/nl-nl/nieuws/2022/33/spanning-op-de-arbeidsmarkt-loopt-verder-op

Figure 2: Number of vacancies, seasonally adjusted



Source: CBS

Tackle long-term labour market bottlenecks expeditiously

The 2023 Budget Memorandum appears to be in two minds in its analysis of labour market issues. The government states, on the one hand, that *"labour market tightness is partly a temporary phenomenon" and*, on the other, it points to *"structural trends that will create bottlenecks in certain sectors in the coming years."*

According to the 2023 Budget Memorandum, the government expects that for the professional groups for which there are most vacancies, the labour market will be broader over time due to structural trends. The government concludes that a significant proportion of vacancies are relatively cyclical: today's vacancies are not necessarily tomorrow's occupations.

The increasing demand for labour is partly caused by the necessary transitions and the ambitions of government policies. Therefore, the CPB expects the labour market to remain tight for the time being. The continued demand for labour in the public sector counterbalances the moderating effect of a cooling economy at present.[27] The Advisory Division observes structural elements of tightness: there is a need to get people to transfer to those occupations where they are needed most now and in the future. This is important, among other things, for tackling social challenges in the healthcare, construction, police and security, defence, education, climate and childcare sectors.[28]

Although the tightness on the labour market is characterised by a cyclical component, the structural components call for structural reforms. Important potential solutions include those formulated by the Committee on Work Regulation and the SER's medium-term advisory report on socio-economic policy 2021-2025.[29] The country-specific recommendations, adopted annually by the Council of the European Union, usually also highlight reforms needed on the Dutch labour market.[30] The Advisory Division has previously requested attention be devoted to necessary structural adjustments in the labour market focusing on lifelong learning and development.[31]

The fact that concrete labour market and social security reforms are necessary is recognised by the government, but does not yet lead to specific legislative proposals in the short term.[32] The 2023 Budget Memorandum acknowledges that *"labour shortages make it difficult to tackle societal challenges expeditiously".* Bearing this in mind, the Advisory Division wonders whether the more structural nature of labour market tightness is not, on balance, underestimated by the government. The Advisory Division thus considers that the government lacks a certain urgency in the labour market policy presented.

Below the Advisory Division cites a number of themes that could be addressed more proactively.

i. Take labour market effects into account in planned policies

The Advisory Division notes that, increasingly, policy intentions raise the question of whether desirable adjustments in policy are feasible, due to the strain on implementing organisations. Therefore, it recommends expanding the existing

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27 CPB Netherlands Bureau for Economic Policy Analysis (2022). 2023 Draft Macroeconomic Outlook (MEV).

28 Parliamentary Documents II 2021/22, 29544, No. 1115.

29 Parliamentary Documents 2019/20, 29544, No. 970, and Economic and Social Council (SER) (2021) Advisory report on socio-economic policy 2021-2025.

30 See, for example, the country-specific recommendations for the Netherlands for 2022 (Council (2022). Recommendation from the Council dated 12 July 2022, regarding Dutch economic policy, and with advice from the Council regarding the Dutch Stability Programme 2022. OJEU, 2022/C, 334/19.)

31 Parliamentary Documents II 2019/20, 35300, No. 3.

32 In its outline paper on the labour market, the government states that the labour market needs a fundamental overhaul to make it future-proof.

implementation analyses and tests on proposed policies by more explicitly considering the labour market effects of proposed policies.[33]

Not only must the capacity needed for the intended new policies be considered, but also whether that capacity can be made available in time, either through new inflows or by re-prioritising existing policies. In the case of re-prioritising, it is necessary to determine which tasks can no longer be performed and how much time and resources it will take to phase them out, before new policies are implemented. As a result, an integrated assessment can be made of whether the importance of new policies outweighs any consequences for already existing policies. It is vital that the legislators, namely the government and parliament, are aware of the implementation aspects when forming new policies. In other words, the ability to implement policies should be considered in terms of the extent of sufficient absorption or implementation capacity.

ii. Government and employers: make it more appealing for people to work more hours

In order to alleviate labour market tightness in the short term, it is important to focus policy on addressing staff shortages in areas where the greatest social challenges as well as major shortages exist. This requires encouraging employees to work more hours, reviewing the legal options for this and removing obstacles to working more hours. The government and employers both play a role in this objective. They have a shared responsibility to address labour market issues.

Making work more appealing starts with offering good working conditions. This includes remuneration. At the moment, there is a historically high real wage decline, which is remarkable given the extremely tight labour market. In the August decision-making process, the government decided on a substantial package of measures to ease the pain for lower and middle incomes in particular. In addition, the government is calling on employers to increase wages.

The CPB and Dutch Central Bank (DNB) also see room for wage growth. For instance, the CPB states that, despite the tight labour market, the increase in wages is markedly limited. From the collective agreements concluded so far, apart from a few recent examples, no substantial acceleration in wage growth is observed, despite the tightness and favourable position of export-oriented sectors in particular. Relatively favourable profits in the corporate sector and a falling labour income ratio in 2023 suggest room for wage growth, according to the CPB, although this will vary greatly by sector and company. The DNB also states that companies are in better shape in terms of profitability and that there is room for wage growth given trends in inflation and labour productivity. However, the DNB

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[33] The IBO Investments also recommends such a test: "Develop a comprehensive overarching implementation test to facilitate political choices within the scarce implementation capacity of the market and government. This facilitates adjustments. The test could be part of monitoring the progress of planned investments from the Coalition Agreement."

does warn that a situation in which wages rise automatically and fully in line with inflation should be avoided. That could further fuel inflation and undermine activity.[34]

Another way to reduce tightness is to look at the unutilised labour potential. In the second quarter of 2022, this concerned over 1.1 million people.[35][36] About 45% of these are part-time workers willing to work more hours. In addition, there are groups who are willing to (continue to) work, but struggle to find work. This includes older (potential) workers. Employers are frequently reluctant to hire older people. At the same time, some employees are subject to compulsory retirement upon reaching retirement age, while some are happy to carry on working. With a structural decrease in labour supply, the abolition of automatic retirement at retirement age, which appears in collective labour agreements and employment contracts, could be considered.

The high percentage of part-time workers deserves special attention. Although the Netherlands currently has the highest employment rate in the world, from the international perspective, the Dutch are also most likely to work part-time.[37] In the past, this has been a source of pride, because of the great flexibility and the opportunity part-time work offers to combine family responsibilities with work. This helped increase the number of women in employment.

Individuals and households make their own trade-offs between valuing labour, their desired income, how care responsibilities are fulfilled (e.g. children and informal care) and the need for leisure time. In other words, decisions on how much one works are based on how much work yields in relation to other tasks and preferences (in terms of broad prosperity).

The outcome of people's individual considerations on whether or not to work part-time has many personal and social grounds that should be respected, but is not always optimal from a collective point of view. Thus, with the current and partly persistent tightness in the labour market, it is collectively desirable to increase the labour supply by having people work more hours in certain sectors. By working more hours, labour market tightness is reduced, collective material wealth is increased and more hours of work are available for work in the public and private sectors. This will prevent pressure on the affordability and availability of public

[34] De Nederlandsche Bank (Dutch Central Bank (DNB)) (2022). Economic Developments and Outlooks. June 2022, number 23 and CPB Netherlands Bureau for Economic Policy Analysis (2022). 2023 Draft Macroeconomic Outlook (MEV). CPB forecast.

[35] This applies to the following groups: 491 thousand underutilised part-timers who have indicated they would like to work more and are readily available to do so, 338 thousand unemployed and 301 thousand semi-unemployed.

[36] Statistics Netherlands (CBS) (2022) Wanted, not available. https://www.cbs.nl/nl-nl/visualisaties/dashboard-beroepsbevolking/gezocht-niet-beschikbaar.

[37] Interdepartmental Policy Research. (2019). De(el)tijd zal het leren. (Time will tell) From analysis to policy, p.9.

services, such as healthcare and safety, and social needs in an ageing society.[38] It also prevents people in healthcare and education, for example, from working even fewer hours because the workload is perceived to be excessive. Staff shortages in the private sector also threaten to hamper the achievement of ambitions, including in relation to the climate and housing.

The Advisory Division points out the potential parallels with early retirement. For a long time, policy has focused on encouraging people to leave the workforce early. The ageing population, among other things, made it necessary to make major adjustments to policy in this regard, including by raising the retirement age. This has contributed to a culture change in thinking about working for longer. Partly because of this, the Netherlands now has a high employment rate among older people by European comparison. The necessary culture change in thinking about part-time work involves encouraging part-time workers to consider working more hours when possible. Schemes should be designed accordingly, incidentally without making part-time work an impossible choice.

The government's role is to remove obstacles that prevent people working more hours. This concerns the tax and benefits system, childcare, school hours and leave arrangements.[39] It is not about discouraging part-time work, nor is it about making everyone work full-time. However, it is important that working more hours is made more appealing. This should include examining how to make working more hours more rewarding. Where the current tax and benefits system discourages working more hours, this should be changed.[40] It should also be considered whether people are sufficiently aware of what they will get out of working more. This encourages citizens to actively adapt their behaviour accordingly.

Bonus for working more hours[41]

The government is exploring the option of a bonus for employees if they decide to work more hours. The debate on a bonus for working more hours is an example of the necessary adjustment of the part-time culture. In response to the previous situation of frequent underpayment of part-time workers and indirect discrimination against women in the labour market, equal treatment legislation stipulated that, in principle, part-time workers be paid the same (pro rata) as full-time workers.[42] Nevertheless, this legislation allows for deviations from this principle if there is justification.

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[38] Interdepartmental Policy Research. (2019). De(el)tijd zal het leren. (Time will tell) From analysis to policy, p.11.

[39] Idem.

[40] In some situations, people lose out on income (a poverty trap) when they start working more hours, as they lose (part of) their means-tested benefits and tax credits.

[41] The Advisory Division deems the term 'full-time bonus' less positive because it is not exclusively about getting people to work full-time. If lots of people start working a few more hours, this can already alleviate many of the staffing shortages.

[42] Article 7:648(1) of the Dutch Civil Code with regard to distinctions based on working hours; Article 7:646(5) of the Dutch Civil Code, the Gender Equality Act and the General Equal Treatment Act with regard to indirect distinctions based on gender.

The present circumstances mean there is reason for allowing such a derogation. The Advisory Division notes that, given the above in the current era, promoting an increase in the number of hours worked by part-time workers can be seen as a legitimate policy objective. This opinion was also expressed by the College for Human Rights in a 2021 opinion on the issue. According to the latter opinion, the question of whether a financial incentive can be considered appropriate, necessary and proportionate should be carefully examined on a measure-by-measure basis. The Advisory Division points out that the government can promote the permissibility of such measures by accurately identifying the sectors (and, if necessary, jobs) where such a financial incentive may be justified. Given the public nature of the issue, it is important for the government to speak out. This clarifies the standard for the individual employer and reduces legal uncertainty.

In the 2023 Budget Memorandum, the government undertakes a number of actions to remove practical obstacles to working more hours, in the new childcare system and by reducing the marginal pressure, among others.[43] At the same time, it also includes measures that have the opposite effect: with the abolition of the income-related combination tax credit (IACK), the 2023 Tax Plan contains a measure that has a negative effect on labour participation, also according to the explanatory memorandum to the relevant bill.

The Advisory Division notes that obstacles also involve cultural aspects: in the Netherlands, women in particular are regularly expected to work part-time and society, for example in school hours, is also organised accordingly. Better alignment of education and childcare and promoting integrated school and childcare options should also help remove obstacles to working more hours.

Employers too, play a role in the consideration of individuals to work more or fewer hours. Employees can be encouraged to work (more) by improving working conditions, both primary (wages) and secondary (type of contract, working hours, holidays, pension scheme, travel expenses, training, childcare facilities, etc.). Being a good employer is also an important role in this regard. By taking into account workers' needs for flexibility in relation to care responsibilities and enabling hybrid work, employers can make it easier for workers to make themselves available to work more hours.

Dissatisfaction with the quality of work is also a major factor why people work fewer hours. Administrative and regulatory burden contributes to a reduced sense of autonomy and own professional responsibility for work. High work pressure can reinforce the desire to work fewer hours. To encourage people to work more hours, it is therefore important not only to look at the quantity of hours worked, but also to pay attention to the quality of work and identify areas where regulatory burden can be reduced.

Administrative burden

[43] Parliamentary Documents 20211/22, 29544, No. 1112.

Almost half of employees in our country feel they have a lack of autonomy.[44] Public professionals in particular, working in education, healthcare or the police force, have little autonomy at work and high work pressure. Administrative and regulatory burden contributes to a reduced sense of autonomy and own professional responsibility for work. Although the administrative operations are meant to improve the quality of service, or provide greater insight into the quality of work, they also weigh on the quality of work. In policy terms, reducing the administrative burden has been a priority for some time, but actual reductions have generally had limited success.[45]

When formulating (new) directives, it should be considered whether the impact of the directive outweighs the (consequences of) the additional administrative burden. Again, not everything is possible, and not all at the same time. Without rebalancing the interests of existing policies and new challenges, no real action can be taken to reduce regulatory burden.

iii. The government also has a responsibility as an employer

The government is not only involved institutionally in the labour market, but is itself a major employer. The public sector, which comprises public administration, public services, education and healthcare, currently provides more than 30 per cent of the total number of jobs (both full-time and part-time) in the Netherlands.[46] Due to major societal challenges, there will be additional demand for staff in the public sector during the current government term.[47] At the same time, it is difficult for the government to implement current tasks due to staff shortages. Parts of the public sector face long-term shortages (e.g. police and defence) or increasing demands for labour in the longer term due to the ageing population (healthcare).

The scope for labour substitution through automation is relatively limited in the public sector. The tasks of government consist mainly of service provision, and services by their nature are more difficult to make productive than is the case for goods (the so-called 'Baumol effect').[48]

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44 Scientific Council for Government Policy (2020) Better work.

45 To combat the regulatory burden in healthcare, the Ministry of Health, Welfare and Sport launched a new Deregulate Healthcare programme, with the aim of healthcare providers spending less time on administration and more time on care.

46 Statistics Netherlands (CBS) (2022), Statline.

47 The CPB Netherlands Bureau for Economic Policy Analysis estimated in its analysis of the Coalition Agreement (CPB (2022). Analysis of the Coalition Agreement 2022-2025. CPB Memorandum, January 2022) that the Coalition Agreement's package of policies lead to an increase in employment in the public sector of 1.1% per year compared with the baseline.

48 The government is suffering from the so-called 'Baumol's disease': in relative terms the government is becoming increasingly more expensive, as productivity cannot be easily increased. Productivity in other sectors is increasing due to higher capital intensity, as a result of which wages will increase in these sectors due to increased economic growth... Less capital-intensive sectors such as government allow their wages to rise in line with market wages to remain competitive, making these labour-intensive sectors relatively expensive.

In an already tight labour market, the government is competing with other employers for staff. The government is calling on employers to increase wages. Therefore, in order to fill its own vacancies, the government itself will also have to consider improving working conditions. In addition, there is tension between the different interests: the socio-economic interests (a prosperous and future-proof Netherlands) and the interests of an efficient government (ensuring the tax burden remains limited) and retaining enough space for the private sector.

In order to make shortages manageable, one could opt to prioritise social challenges and, in addition to improving secondary benefits, one could opt for targeted wage increases for specific parts of the public sector. This concerns sectors where the shortage of personnel is greatest for the social challenge to be addressed, or in those professional groups where the supply of personnel is specifically deficient.

The government's contribution to the scope for wage increases in the public sector is currently based on tracking wage cost trends in the market.[49] The budgetary scope determined partly as a result will be used by public employers in the collective labour agreement negotiations, in which agreements are reached with the social partners on the distribution of funds among primary and secondary employment conditions for the various positions. This means higher wage increases can be agreed for some groups rather than others.[50]

On several occasions in the past, the option has been for a policy-based downward revision of the scope for wage increases and a reduction in working hours to cut public spending. This has generally had adverse effects on public employers' personnel policies, but beneficial effects on public finances.[51]

With labour market tightness making it difficult to tackle societal challenges, with potentially major consequences for prosperity, the question needs to be asked whether the models that determine the government's contribution to determine the scope for wage increases still meet the needs of the changing labour market and whether they are in need of renewal. Changing the assumptions of these models for allocating funds for the scope for wage increases and their application provide both advantages and disadvantages and require a political choice. The choice should be made explicit, by making the various trade-offs transparent. Therefore, the Advisory Division recommends that the government evaluate the current models from this perspective, and adjust them if necessary.

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[49] These include the reference model and - for the healthcare sector - the OVA covenant.

[50] Ministry of the Interior and Kingdom Relations (2022). Bargaining result for the collective labour agreement for central government 2022-2024.

[51] Ministry of the Interior and Kingdom Relations (2017). Reference model evaluation. Experiences after twenty years of using and applying the model. Report, July 2017.

E. 2022 SEPTEMBER REPORT

1. Budgetary process

With the current government taking office, the main decision-making moment in the spring on the following year's draft budget has gained more weight. On the advice of the 16th Study Group on Fiscal Policy, not only the main points of the expenditure side of the budget for the following year are decided in the spring, but also those on the tax side. This promotes the integrality of budgetary considerations and creates calm in the budgetary process.

In the past, the main decision-making moment was considered an internal Cabinet meeting. This meant that parliament only obtained an insight into the budgetary decision-making process on Budget Day. In response to the Advisory Division's advice on the 2022 Budget Memorandum,[52] the government decided to adjust the budgetary process, with the aim of (1) giving parliament more time to debate the budget and the Tax Plan, (2) achieving greater substantive cohesion in the budget, and (3) aligning it more effectively with the European Semester.[53]

The government proposed several options for modifying the budgetary process to the House of Representatives and started implementing its preferred option this year, i.e. compiling a multi-year Spring Memorandum. The new-style Spring Memorandum means that parliament is involved sooner in budgetary decision-making on both the expenditure and tax side. The intention is for an update on decision-making for purchasing power based on the CPB's draft Macroeconomic Outlook (MEV) to be issued in August, after which the final draft budgets will be submitted with the Budget Memorandum on Budget Day.

In its opinion on the Spring Memorandum, the Advisory Division concluded that the first multi-year Spring Memorandum was a good initial step towards a new budgetary process, but that the design is not yet complete.[54] Thus, decision-making in the spring was incomplete with regard to a number of issues, such as taxing wealth more heavily; initial proposals were not made until this Budget Memorandum.

During the August decision-making process, a comprehensive package of measures to support purchasing power was decided as a result of the forecast by the CPB regarding the unprecedented decline in purchasing power in the draft Macroeconomic Outlook (MEV). This package consists of a substantial number of

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[52] Parliamentary Documents II 2021/22, 35925, No. 3. In its opinion on the 2022 Budget Memorandum, the Advisory Division provided recommendations to parliament for reinforcing its rights associated with the budget. The Advisory Division proposed, among other things, that from now on, the Budget Memorandum be submitted in the spring, so that the Dutch budgetary process is aligned more effectively with the European Semester, and the House of Representatives and the Senate are better placed to act in a more timely manner.

[53] Parliamentary Documents II 2021/22, Letter to Parliament on the Budgetary Process, April 2022.

[54] June Report 2022, Parliamentary Documents II 36120, No. 3 W06.22.0084/III/B

measures, which will also have knock-on effects on other schemes. Its impact is unclear due to the very short time frame in which this package was decided. Moreover, as announced in the Spring Memorandum, the government has taken the first steps to achieve a greater balance with regard to the taxation on labour and capital.[55]

As a result, the consequences of the choices made in the August decision-making moment are hard to oversee, whereas the aim of the new budgetary process is to bring more calm and promote integral decision-making. The Advisory Division understands the exceptional circumstances in which the government is operating, that, on the one hand, require targeted measures to restore purchasing power but on the other, targeted measures are not always possible due to bottlenecks in implementation.

However, the rushed process in August not only stands in the way of careful decision-making, but also issues other than direct purchasing power, such as wealth tax. Moreover, the opportunities to make adjustments in August in response to the CPB's recent purchasing power forecasts are very limited, as many new measures, apart from parameter changes, are simply not feasible in the short term, this and next year (see also Section C).

The Advisory Division advises the government to take the next step towards a new budgetary process next year, by ensuring it, the House of Representatives and the Senate adhere even more strictly to the agreements for the new budgetary process.

2. Assessment under European fiscal rules

2.1. European fiscal rules for 2022 and 2023

In its September Report, the Advisory Division assesses whether public finances in the current year (in year) and in the year ahead (ex ante) comply with European fiscal rules.

European fiscal rules are set out in the Stability and Growth Pact (SGP). The SGP consists of a corrective and a preventive arm. The requirements of the corrective arm are a deficit rule of no more than 3% of GDP and a debt criterion of no more than 60% of GDP. If the debt criterion is exceeded, the debt must be reduced by at least one-twentieth each year (debt reduction path). The requirements of the preventive arm consist of the medium-term objective (MTO), also known as the structural balance, and the expenditure rule. These requirements are intended to ensure that Member States implement countercyclical fiscal policy and include a safety margin in relation to the 3% deficit rule. The purpose of the preventive arm is to prevent Member States being confronted with excessive deficits. If there

[55] See also the Advisory Division's opinion on the 2023 Tax Plan.

comes a point when Member States fail to comply with the rules in the preventive arm, the basic principle is that Member States are subject to the corrective arm.[56]

Due to the start of the Covid-19 pandemic, in March 2020, the European Commission activated the general escape clause of the SGP. This affords Member States maximum flexibility within the SGP to make additional fiscal efforts.[57]In the European Commission's Spring Package, as part of the European Semester, it was decided to extend the application of the general escape clause up to and including 2023, due to the economic consequences and uncertainties arising from the war in Ukraine.[58]

Before the start of the Covid-19 crisis, the Netherlands was in the preventive arm of the SGP. For Member States in the preventive arm the general escape clause means that they may deviate from the path towards the medium-term objective (MTO) for the structural balance, providing it does not jeopardise the sustainability of public finances in the medium term. The guidelines for the budgetary assessment in 2020-2023 are largely qualitative. However, the regular procedures of the SGP have not been suspended, so it remains important that the development of public finances is continuously assessed.

For the years after 2023, the outcome of the evaluation of the SGP, the European Semester and the Macroeconomic Imbalances Procedure (MIP) is relevant. The five-year evaluation of the framework was suspended in 2020, due to the Covid-19 crisis. The European Commission resumed the evaluation in the autumn of 2021. A Commission communication on possible adjustments to the framework is expected to be announced this autumn.

At the request of the House of Representatives, the Advisory Division issued information on the evaluation of the SGP in early 2022.[59] It has not yet been the subject of parliamentary debate. The government issued a joint position paper on SGP reforms with Spain in the spring of 2022. This is in line with the aforementioned information.[60] Interest rate spreads on government bonds between Member States have widened. As this could put pressure on the stability of the eurozone, it is important to decide on the future design of the SGP no later than the first quarter of 2023.

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[56] In both the corrective and preventive arms, there are a number of exceptions to the requirements, also known as flexibilities. For an overview of these flexibilities, see pages 7 and 8 of Annex III of the Advisory Division's Guidance on the options for reforming the Stability and Growth Pact (W06.22.0005/III/Vo), Parliamentary Documents II 2021/22, 35925, No. 146.

[57] European Commission, Communication from the Commission to the Council on activating the general escape clause of the Stability and Growth Pact, COM (2020) 123 final.

[58] European Commission, Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank on the 2022 European Semester, Spring Package, COM (2022) 600 final, pages 12-14.

[59] Parliamentary Documents II 2021/22, 35924, No. 146.

[60] Parliamentary Documents II 2021/22, 21501-07, No. 1837.

At the same time, it is clear that there will be a continued focus on debt sustainability, investments and reforms and on increasing Member State ownership of fiscal policy.[61] All the more so since one of the SGP's essential objectives, as part of the EMU, is to guarantee the sustainability of public finances also in the longer term. Economic growth and convergence in the eurozone is the other essential objective. Therefore, the Advisory Division will devote extra attention to this in the budgetary assessment.

2.2. Assessment for 2022 and 2023

With an estimated actual budget deficit of 1% of GDP and government debt of 49.6% of GDP, in 2022, the Dutch budget complies with the requirements of the corrective arm of the SGP of a maximum deficit of 3% of GDP and, respectively, maximum debt of 60% of GDP.

The structural balance in 2022, at -1.7% of GDP, improved significantly compared to the structural balance estimated by the Ministry of Finance in the Spring Memorandum of -3.9% of GDP. The estimated improvement of 2.3 percentage points is mainly due to the strong improvement in the actual EMU balance of 2.4 percentage points compared to the Spring Memorandum. The striking recovery is mainly due to temporary factors, see also Section B2 of this report.

Despite the strong improvement in the structural balance, the projected outcome for the structural balance deviates significantly from the medium-term objective (MTO) for the structural balance of -0.5% of GDP in 2022. Member States with a structural balance worse than the MTO must comply with the expenditure rule.[62] To comply with the expenditure rule in 2022, public expenditure adjusted for, among other things, interest expenditure and cyclical expenditure on unemployment benefits (see also the notes at the bottom of Table 3) must fall by 1.7% in real terms. In 2022, however, adjusted public expenditure is expected to rise 3.9% in real terms. As a result, the Dutch budget does not comply with the rules of the preventive arm of the SGP in 2022.

Table 3: Figures for European fiscal rules 2021-2023

	2021	**2022**	**2023**
	ex-post	*in year*	*ex-ante*
Rule in relation to the development of the structural balance (% of GDP)			

[61] European Commission (2022) Communication from the Commission to the Council. Fiscal Policy Guidance 2023, COM (2022), 85 final.

[62] The expenditure rule within the preventive arm requires that government spending should not increase faster than potential economic growth, also taking into account the distance to the MTO. The idea behind the expenditure rule is that revenues move with the economic cycle and expenditure does not increase faster than potential economic growth, thereby preventing the structural balance from deteriorating.

Maximum actual EMU balance	*-3.0*	*-3.0*	*-3.0*
EMU balance (actual)	-2.6	-1.1	-2.5
Cyclical component	-0.8	0.8	0.7
One-off and other temporary measures	0.0	-0.2	-0.1
Medium-term objective structural EMU balance	*-0.5*	*-0.5*	*-0.75*
Structural EMU balance (EC method)	-1.8	-1.7	-3.0
Expenditure rule			
Corrected public expenditure (real change in %)	2.3	3.9	1.4
Max. permitted growth corrected net government expenditure**	-2.6	-1.7	-3.8
Debt criterion (% of GDP)			
Maximum EMU debt	*60.0*	*60.0*	*60.0*
EMU debt	52.4	49.6	48.8

* Public expenditure, in accordance with European fiscal rules, has been corrected for interest expenditure, cyclical expenditure on unemployment benefits, expenditure on EU programmes funded by transfers from the EU and with a four-year average for public investment.

** Standard growth is the potential growth, corrected for the distance to the medium-term objective (MTO) for the structural EMU balance.

Source: CPB (Macroeconomic Outlook (MEV) 2023)

In 2023, the Dutch government budget is expected to comply with the rules in the corrective arm of the SGP, with an expected EMU balance of -2.5% of GDP and EMU debt of 48.8% of GDP (see Table 3).

In the Stability Programme 2022, the Netherlands has indicated that it will opt for a medium-term objective (MTO) for the structural balance of -0.75% of GDP from 2023 onwards.[63] With a projected structural balance of -2.5% of GDP in 2023, the balance does not meet the MTO for the structural balance. To comply with the expenditure rule in 2023, adjusted public spending needs to fall by 3.8% in real terms. In 2022, however, adjusted public expenditure is expected to increase by 1.4% in real terms. As a result, the Dutch budget does not comply with the rules of the preventive arm of the SGP in 2023, which was also the case in 2022.

[63] Parliamentary Documents II 2021/22, 21501-07, No. 1840, Annex 1028111.

Table 4: Summary overview of the outcome of the assessment under European fiscal rules

	2021	2022	2023
Rules of the preventive arm:			
Structural EMU balance[(a)]	×	×	×
Expenditure rule	×	×	×
Rules of the corrective arm:			
Actual budget balance	✓	✓	✓
Government debt	✓	✓	✓

Explanatory note on symbols used: ✓ = compliance with the relevant rule; O = there is a deviation from the rule, but the deviation is not significant; × = there is a deviation from the rule, and calculated over one year and/or over two years, on average this deviation is significant (only applies to the structural balance and expenditure rule, see note)

(a) For the structural budget balance and the expenditure rule there is evidence of a 'significant' deviation if the deviation (in a negative sense), calculated over one year amounts to at least 0.5% point of GDP. It also qualifies as a significant deviation if there is evidence of a deviation of at least 0.5pp of GDP cumulatively over two years.

(b) As long as the structural budget balance complies with the medium-term objective, an assessment of the expenditure rule may be omitted.

The purpose of the rules in the preventive arm is to prevent Member States being confronted with excessive deficits. The moment those deficits do arise, the corrective arm regime applies as the basic principle. Due to the general escape clause currently being active, in 2022 and 2023, the overshoots in the preventive arm will not have any consequences, providing the sustainability of public finances is not jeopardised in the medium term.

A debt sustainability analysis by the CPB shows in the Budget Memorandum that in the baseline, debt is expected to reach around 60% of GDP in 2030. Under more unfavourable scenarios, public debt could rise to almost 80% of GDP by 2030 (see Section E4). Therefore, it is important to continue monitoring the sustainability of public finances.

3. Assessment under national fiscal rules

3.1. National fiscal rules for 2022 and 2023

Since 1994, successive governments have opted for trend-based fiscal policy. In the Initial Policy Memorandum to the Coalition Agreement the government established and confirmed that it will pursue trend-based fiscal policy.[64] On the expenditure side, expenditure frameworks (State Budget, Social Security, Healthcare and the new Investment Framework) are established for the entire government term, each with an annual expenditure ceiling that may not be exceeded. However, the individual expenditure ceilings are indexed annually in relation to wage and price development.

[64] The Rutte IV Government Initial Policy Memorandum, Parliamentary Documents II 2021/22, 35925, No. 143.

On the revenue side a revenue framework applies with automatic stabilisation: revenue windfalls benefit the government balance, revenue shortfalls burden the government balance. In this way, revenue moves in tandem, as it were, with the business cycle. In principle, the expenditure ceiling and the revenue framework will not be adjusted during the government term, which means that the frameworks set policy-based upper limits for public finances.

In the frameworks revenue and expenditure are separate. This means that windfalls on the revenue side may not be used for additional expenditure, but also that revenue setbacks do not have to be offset by cuts on the expenditure side. Moreover, setbacks on the expenditure side must be compensated within the expenditure framework and must not lead to new measures on the revenue side. This provides maximum scope for automatic stabilisation and avoids pro-cyclical fiscal policy.

Pursuing trend-based fiscal policy does not guarantee a certain outcome with regard to European fiscal targets. The purpose of enforcing national fiscal rules is to ensure that public finances remain within the limits of what the government deems acceptable. The decision to establish the level of the budgetary frameworks at the beginning of a government term is a political choice. The 2022 Spring Memorandum establishes the expenditure ceiling and the revenue framework for the current government term.

In successive opinions, the Advisory Division has advised that, in order to promote both sustainable public finances and democratic decision-making, fiscal policy should be determined in a transparent manner, by specifying budgetary anchors for fiscal policy.[65] The formulation of budgetary anchors ensures that decisions and possible reforms are weighed up integrally on the basis of politically chosen criteria. The government's Initial Policy Memorandum lacked such a control variable. In the Spring Memorandum the government states that the revenue and expenditure frameworks thus serve as an anchor for this government term's budgetary policy.

As mentioned previously in the June Report on Fiscal Monitoring, the establishment of the frameworks, and thus the policy-based limitation of public finances, stands or falls with the discipline of both the government and parliament to respect and enforce the frameworks during the government term. Only then can the budget contribute to economic stabilisation. In the 2022 Spring Memorandum, the government states that the limit of expenditure the government considers acceptable has been reached with the additional intensification announced in the Spring Memorandum. The government also emphasises that, in

[65] See, among others, the April Report 2022 (Parliamentary Documents II 21501-07, No. 1840), the June Report 2022 (Parliamentary Documents II 36120, No. 3), the opinion on the 2022 Budget Memorandum (Parliamentary Documents II 2021/22, 35925 No. 3) and the opinion on the 2021 Budget Memorandum (Parliamentary Documents II, 2019/20, 35570, No. 4).

principle, coverage will have to be provided for new policies with budgetary implications.

3.2. *Assessment for 2022 and 2023*

Commitment to own fiscal rules
The government took a number of additional measures in the 2023 Budget Memorandum. The total policy package leads to a deterioration of the EMU balance of almost €4 bln in 2023. Structurally, the package yields a small plus, thus having a positive impact on the EMU balance. The government considers the temporary deterioration of the balance justified given the extent of the purchasing power problem and the fact that the budget improves in the longer term due to the sum of the measures.

In the 2022 Spring Memorandum the government states that the limit of expenditure the government considers acceptable has been reached and that in principle, new policy that had consequences for the budget will have to be covered.[66] However, the 2023 Budget Memorandum policy package again leads to further uncovered intensifications in the short term. Due to the improvement in the EMU balance and debt compared to the CEP due to temporary factors, this does not lead to major consequences for now. However, these overshoots mean that the government is not abiding by its own fiscal rules.

In the 2022 Spring Memorandum the separation of revenue and expenditure is not respected by the government in various policy cases, thus violating its own fiscal rules.[67] The additional measures from the August decision-making process did not lead to further violations of the separation between revenue and expenditure.

Ceiling tests not possible once more
Moreover, the CPB's CEP forecast (March 2022) does not include ceiling tests of expenditure frameworks and an assessment of the budget's revenue framework because the government did not formally establish the frameworks in the Spring Memorandum. The government adjusted the expenditure ceilings and corrected the revenue framework in both the Spring Memorandum and the Budget Memorandum. However, due to the delay in political decision-making and the many reviews and ceiling adjustments arising from new policies, once again, it was not possible for the CPB to provide a complete overview and analysis of all ceiling adjustments and framework corrections made by the government in the August decision-making process.

As a result, the assessment under national fiscal rules is incomplete. The rushed budgetary process in August puts considerable pressure on the CPB's calculation and stands in the way of careful scrutiny of fiscal rules. The Advisory Division deems this a worrying development. All the more so as in the Spring

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[66] Spring Memorandum 2022, Parliamentary Documents II 2021/22, 36120, No. 1
[67] June Report 2022, Parliamentary Documents II 36120, No. 3 W06.22.0084/III/B.

Memorandum the government states that the revenue and expenditure frameworks thus serve as an anchor for this government term's budgetary policy. An orderly budgetary process is in the interest of democracy, to provide independent insight into the impact of government policies on society, the economy and the budget. Also in exceptional situations.

4. The sustainability of public finances

An essential objective of the SGP is to guarantee the sustainability of public finances. Consequently, the sustainability of public finances in the medium and long term is an extremely important factor in the budgetary assessment. The sustainability of public finances involves both financial sustainability and intergenerational sustainability. In the June 2022 report, the Advisory Division advised that the 2023 Budget Memorandum should address debt sustainability under different economic scenarios and the sustainability of public finances for future generations, partly in relation to broad prosperity.

It is positive that the government addresses both financial sustainability and the sustainability of public finances for future generations in the 2023 Budget Memorandum. Scenarios on the development of public finances at different interest rates are also included. This ensures that the various aspects of sustainable public finances are included in policy considerations.

Based on an analysis by the CPB, the Budget Memorandum looked at the development of public debt in the medium term, namely up to 2030. The results of the CPB analysis show that in relation to the baseline, debt is expected to reach around 60% of GDP in 2030. In more unfavourable scenarios, public debt could rise to almost 80% of GDP by 2030, thus creating a real possibility that public debt will exceed the SGP's rule of 60%.

The government considers a temporary increase in public debt justified because of necessary investments through the climate and transition funds, among others. The Advisory Division points out that when addressing challenges related to the climate and nitrogen issue, it is always important to consider whether a financial investment is needed or whether another policy instrument would be more efficient or effective. In other words, provide a transparent trade-off between subsidising, standardising or pricing. For instance, in existing climate policy, the trade-offs involved in opting for a particular policy instrument are not always transparent.[68]

The ageing population and the government's investment agenda have implications for intergenerational distribution of the tax burden. For instance, in the Budget Memorandum, the government demonstrates that the ageing population will affect public finances as a result of a reduced labour supply, higher healthcare spending

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[68] See also the Advisory Division's 2022 Climate Analysis.

and a higher number of state pension payments. Current and future interest rates also have an impact on the intergenerational sustainability of public finances. To reduce the tax burden on future generations for which there are minor benefits, it is important to reduce the impact of the ageing population as much as possible. This will require, among other things, structural reforms to keep healthcare costs manageable.

In this context, the Advisory Division refers back to its opinion on the draft Budget Memorandum in Section C of this report to focus on policy cycles longer than four years, e.g. 2030 and 2050, as is explicitly the case with the Climate Transition.

5. Focal points related to the expenditure frameworks

Transparency
In its budget reports the Advisory Division usually reflects on the extent to which budget-relevant issues are transparently presented, because of the importance of well-founded opinion-forming by parliament and public support for policy. In the 2022 April and June Reports the Advisory Division noted progress in the transparent presentation of budget-relevant topics.[69]

The Advisory Division notes that the government once again devotes attention to the transparent presentation of budget-relevant topics in the 2023 Budget Memorandum. The government again provides insight into the multi-year horizontal (year-on-year) development of expenditure and taxes, as well as into the development of total taxes and expenditure. In addition, the government presents the expenditure related to Covid-19 and the war in Ukraine in a separate table.

Following the evaluation of the government-wide reporting system, the government presents several proposals on how to improve the provision of information. A number of projects involving the digitisation of information related to budgetary and accountability processes are also ongoing. The government seeks to increase understanding of the efficiency and effectiveness of current and proposed policies by enhancing the government-wide evaluation system.

In addition, in the 2023 Budget Memorandum, the government presents an overview of the development of funds under the newly created investment ceiling. The government is thus implementing a recommendation from the Interdepartmental Policy Research (IBO) Public Investments. The Advisory Division considers presenting the progress of funds under the investment ceiling as a good first step, but also sees vantage points for refinement. The Advisory Division

[69] April Report 2022, Parliamentary Documents II 21501-07, No. 1840, W06.22.0055/III and June Report 2022, Parliamentary Documents II 36120, No. 3 W06.22.0084/III/B.

refers to the recommendation by the Interdepartmental Policy Research (IBO) to focus on the feasibility of proposed policies.[70]

In the Budget Memorandum the development of resources is mainly described and explained in general terms. This means that any underlying causes and risks are not yet sufficiently understood.[71] The Advisory Division recommends that the budgets of the individual funds take a more in-depth look at the development of resources under the investment ceiling, including by identifying underlying causes and risks. This is all the more important since it appears that for various reasons, not all investment funds can be spent at the current pace.

Underspending
In its April Report, the Advisory Division drew attention to the threat of underspending with regard to the government's planned intensification in various policy areas.[72] The CPB now estimates that a substantial part of the planned intensifications cannot be achieved due to the tight labour market. The government itself also expects underspending in the coming years. An additional target-based underspending with a cumulative amount of €4.7 billion has been booked, which will be used for the policy package in the 2023 Budget Memorandum.[73] Should the underspend be lower, it will lead to an overshoot of the expenditure framework and a deterioration in the EMU balance.

The tight labour market is expected to constitute an obstacle for achieving planned intensifications for a considerable period of time. Spending resources is not an end in itself. The estimated underspending for the coming years is an indicator that the intended results of the planned intensifications are lagging behind. This could lead to a downward revision of policy ambitions. The fact that not everything is possible, and not at the same time (see also Section C) is also evident here. In the meantime, the social challenges and formulated goals apply in full and are also subject to deadlines.[74] This is another reason why a coherent structural analysis is important, in order to reinforce long-term priorities (see also Section C).

6. <u>Focal points related to the tax framework</u>

General government revenue
The Advisory Division also calls for attention to the revenue side of the government's budget in the budgetary reports. The total revenue ratio provides insight into the development of government revenue and is the simplest tax

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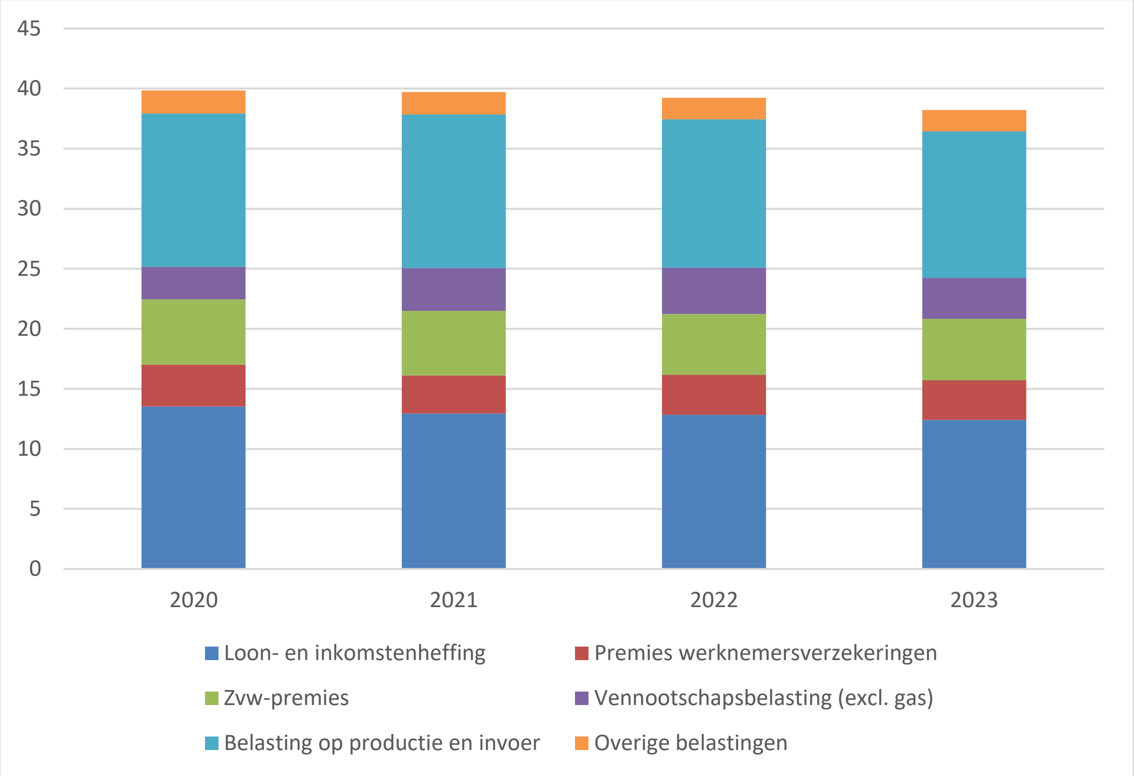
[70] Interdepartmental Policy Research (IBO) (2022). Investment in a political-administrative context 'Value for money'.
[71] Parliamentary Documents II 2021/22, 35925, No. 173.
[72] April Report 2022, Parliamentary Documents II 21501-07, No. 1840, W06.22.0055/III
[73] In line with this government's Initial Policy Memorandum, it is possible to use underspending that occurs after the Spring Memorandum to achieve the target.
[74] Consider, for example, the climate target of a 55% reduction in emissions by 2030 in the Climate Act, and the quantitative target of one million additional homes by 2030.

concept. The total revenue ratio decreases slightly compared to 2020 and 2021, reaching 39.2% of GDP in 2022 and 38.2% of GDP in 2023. Figure 3 shows the breakdown by type of tax and contribution. At the time of writing this report, figures on policy-related tax developments were not yet available. As such, this report lacks insight into policy-related tax developments.

Figure 3: tax and contribution receipts in % of GDP



Source: MEO 2023

In the 2023 Budget Memorandum, the government considers the distribution between the tax burden on labour and capital and presents an agenda for the balanced taxation of wealth. Interdepartmental Policy Research (IBO) on wealth distribution highlights major, increasing differences between groups of households in terms of wealth distribution.[75] According to the report, current fiscal policy increases household disparities in existing wealth distribution. The report points out that excessive concentration of wealth and skewed distribution are harmful to both the economy and society. The IBO offers specific policy options to address the concerns identified.

7. Fulfilment of commitments previously made by the government

The Advisory Division has issued several opinions to the government that took office this year. The opinion on the 2022 Budget Memorandum contained advice to consider when shaping the new government's fiscal policy.[76] In 2022, the Advisory Division issued several opinions to the government in its letter accompanying the Initial Policy Memorandum with recommendations on fiscal

[75] Interdepartmental Policy Research (IBO) (2022). Lights off, Focus on Wealth Distribution.
[76] Parliamentary Documents II 2021/22, 35925, No. 3.

policy, in the April Report based on the government's Stability Programme and in the June Report based on the government's Spring Memorandum.[77]

One of these opinions concerned providing anchors for fiscal policy and returning to an orderly budget process. In Sections E3 and E1 of this report, respectively, the Advisory Division further discusses the government's implementation of these opinions. The Advisory Division also recommended the inclusion of scenarios of debt sustainability with multiple economic scenarios and a more in-depth look at the sustainability of public finances. As stated in Section E4, the government addresses both issues in the 2023 Budget Memorandum. However, in this context, the Advisory Division highlights the importance of structural reforms to minimise the impact of an ageing population, including on future generations.

In addition, the Advisory Division has repeatedly pointed out the importance of aspects of broad prosperity in fiscal policy.[78] In the 2023 Budget Memorandum, the government demonstrates it has made progress in anchoring broad prosperity in the budget cycle. This is a gradual process, which brings longer-term steering using indicators of broad prosperity closer. See Section C in this report for more information on broad prosperity.

Lastly, in the April and June Reports 2022, the Advisory Division noted that the (explanation of the) cohesion between financial and socio-economic government policy is limited in both the Coalition Agreement and the Stability Programme. Consequently, the Advisory Division recommended that the government's first Budget Memorandum be used for the purpose of a coherent structural analysis. The Advisory Division notes that such an analysis is not part of the 2023 Budget Memorandum and advises the government to make such an analysis part of the Reform Programme to be submitted to the European Commission as part of the European Semester in spring 2023 (see also Section C of this report).

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[77] Letter Initial Policy Memorandum 2022 (Parliamentary Documents II, 2021/22, 35925, No. 144), April Report 2022 (Parliamentary Documents II 21501-07, No. 1840, W06.22.0055/III) and June Report 2022 (Parliamentary Documents II 36120, No. 3 W06.22.0084/III/B).

[78] See, for example, the April Report 2022 (Parliamentary Documents II 21501-07, No. 1840), the June Report 2022 (Parliamentary Documents II 36120, No. 3), the Opinion on the 2022 Budget Memorandum (Parliamentary Documents II 2021/22, 35925 No. 3) and the Opinion on the 2021 Budget Memorandum (Parliamentary Documents, 2019/20, 35570, No. 4).

F. RESPONSE FROM THE GOVERNMENT

Introduction

"The government thanks the Advisory Division of the Council of State (hereafter referred to as: the Advisory Division) for its assessment on the development of public finances and the extent to which this development complies with the rules of the Stability and Growth Pact (SGP).

The September Report addresses the following points, which are discussed step by step below and provided with a response on behalf of the government:

- A.1. Budgetary process
- A.2. Assessment under European fiscal rules
- A.3. Assessment under national fiscal rules
- A.4. The sustainability of public finances
- A.5. Focal points related to the expenditure frameworks
- A.6. Focal points related to the tax framework
- A.7. Fulfilment of commitments previously made by the government

A.1. Budgetary process

The Advisory Division expresses its appreciation with regard to the review of the budget process, as set out in the Letter to Parliament dated 13 April.[79] However, the Advisory Division does recommend that further steps be taken next year to comply with the budget agreements made. It is noted in the September Report that an additional package was put together in a short period of time in August, with limited insight into its exact impact.

In the Letter to Parliament on the Budget Process, the government indicated that it wanted to base decisions in August on the most up-to-date economic outlook possible. With the current inflation and economic situation, this is certainly important. Because of the historically large decline in purchasing power, the government was forced to put together a comprehensive support package in a short time frame. The government also agrees that fiscal policy benefits from a good process and strict adherence to the agreements and remains committed to this in the coming years.

A.2. Assessment under European fiscal rules

The Advisory Division indicates that the overshoot of the structural balance in 2022 and 2023 will have no consequences due to the activation of the SGP escape clause. However, the Advisory Division does indicate that, despite the general escape clause, it remains important to closely monitor and assess the development of public finances and make efforts to comply with European fiscal rules.

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[79] Parliamentary Documents II 2021/22, Letter to Parliament on the Budget Process, April 2022.

The government shares this view and recognises the tension with European threshold values. In the Coalition Agreement, the government deliberately opted for an ambitious investment agenda, including combating climate change, tackling the nitrogen crisis and investing in future prosperity through education and innovation. The high cost of these investments is necessary to avoid even higher costs in the future. The government deems the risk of a temporary deterioration in public finances acceptable in view of the urgency of the investments.

A.3. Assessment under national fiscal rules

The Advisory Division advises the government to continue to pursue trend-based fiscal policy throughout the government term as a budgetary anchor. It also states that the establishment of the frameworks, and thus the policy-based limitation of public finances, stands or falls with the discipline of both the government and parliament to respect and enforce the frameworks.

The government agrees with this opinion. The government acknowledges that the purchasing power package leads to a deterioration of the EMU balance for 2023 and 2024 and an overshoot of the expenditure ceiling and revenue framework. At the same time, the package is structurally covered and leads to an improvement in the EMU balance in the medium term.

A.4. The sustainability of public finances

The Advisory Division expresses its appreciation of the analysis in the Budget Memorandum 2023 regarding the financial and intergenerational sustainability of Dutch public finances. In the context of the ageing population - with the expectation of significant implications for future public finances - the Advisory Division recommends adopting policy cycles longer than four years, e.g. 2030 and 2050. In addition, the Advisory Division suggests that the core set of broad prosperity indicators to be developed, should focus on at least 2030 and 2050, thus providing a basis for a longer-term (policy) cycle.

The government endorses the importance of monitoring the long-term implications for public finances. Policy cycles longer than four years, as also described by the Advisory Division, are to a certain extent already applied, for example, in the climate and nitrogen funds that run until 2030 and 2035, respectively. Moreover, in the Budget Memorandum attention is devoted each year to long-term challenges to public finances such as the ageing population. The development of the core set of broad prosperity indicators lies primarily with the assessment agencies and the government is in agreement with the approach they have chosen. However, the government recognises the notion that the major social challenges are not limited to a four-year perspective and underlines the Council of State's plea that the broad prosperity indicators do not lend themselves to continuous steering, but are important for monitoring the development of trends in society and making adjustments where possible.

A.5. Focal points related to the expenditure frameworks

The Advisory Division is positive about demonstrating the horizontal development of expenditure. An important aspect in the development of expenditure in the coming years includes the investment ceiling. Thereby, in line with the recommendation of the Interdepartmental Policy Research (IBO) Public Investments, it is recommended that in-depth discussions focus on the feasibility of proposed policies. The Advisory Division also recommends that the budgets of the individual funds take a more in-depth look at the development of resources under the investment ceiling, including by identifying underlying causes and risks. In addition, the Advisory Division indicates that it is important to be transparent about the expected underspending, given the cumulative €4.7 billion in target-based underspending for the purchasing power package.

The government agrees with the Advisory Division's opinion. In the coming period, the government will further elaborate on the resources from the investment fund in the budget documents. This will include the consideration of feasibility and risks. Interdepartmental Policy Research (IBO) Public Investments oversees the development of Coalition Agreement funds. In the Budget Memorandum, the government indicates that in 2022, a clear distinction can still be made between regular investment funds and Coalition Agreement funds. Once Coalition Agreement resources are transferred to the funds, this distinction disappears as the funds are usually added to existing budgets. This will make it clear in the coming years how the ceilings of the various funds evolve and the underlying causes for the shifts. The government will monitor this.

Regarding underspending, the government considers the underspending booked by the government realistic, also given the historical trend and the CPB's expectations. Sometimes, as the Advisory Division notes, this is also a consequence of the tight labour market. The government assumes that the social goals of the investment agenda will not be jeopardised.

A.6. Focal points related to the tax framework

The Advisory Division notes with regard to the tax framework that at the time the draft report was prepared, the policy-based tax development was not yet available. In addition, the Advisory Division argues that the Interdepartmental Policy Research (IBO) wealth makes valuable policy recommendations to address the concerns identified in terms of wealth distribution.

The government acknowledges that the August decision-making process was complex due to the historic decline in purchasing power, and will make an effort in the coming year to share this policy-based tax development with the Advisory Division in a timely manner. The government also endorses the valuable recommendations of the Interdepartmental Policy Research (IBO) wealth. Section 3.1 of the Budget Memorandum sets out the measures taken in this regard and how this will be integrated further.

A.7. Fulfilment of commitments previously made by the government

The Advisory Division welcomes the increasing focus on broad prosperity in the 2023 Budget Memorandum. The Advisory Division also recommends making a socio-economic structural analysis part of the Reform Programme to be drawn up annually in the spring as part of the European Semester. The Advisory Division recommends bringing together separate passages from the Budget Memorandum and building blocks from the various (outline) letters to produce a coherent whole, setting out the different components of economic growth, the strengths and weaknesses of our economy and the groups that have benefited from the growth. It also addresses the implications for reforms and policies in the long term. The Advisory Division lists three elements that should recur: the impact of EU policies, broad prosperity, and the quality of public spending.

As the Advisory Division points out, this Budget Memorandum takes another step towards anchoring broad prosperity in the policy cycle. By indicating the broad prosperity priorities, and reporting on them annually in the Budget Memorandum, the government ensures that this is communicated in one place in a coherent manner. If this is eventually accompanied by the core set of the assessment agencies' broad prosperity indicators, the government is convinced that it will provide an integral and independent framework for thinking about broad prosperity. These building blocks can subsequently be used for structural analyses of financial and socio-economic government policies.

In addition, the Budget Memorandum contains an analysis chapter (Chapter 3 in the 2023 Budget Memorandum), in which space is devoted to exploring cross-cutting themes in more depth. The next Budget Memorandum will also include such a chapter. The government would also like to point out that although the (outline) letters already published mainly describe the direction for individual policy areas, this does not mean that there is no consideration of the connection with other challenges. For instance, the upcoming National Energy System Plan will explicitly take into account the connection with spatial planning and social and societal issues. The development process for this plan will also be designed in such a way to ensure cohesion between different policy areas.

The government sees the importance of structural analysis, and is going to examine how it can be followed up. The government's preference is to focus the Reform Programme on new concrete policies that contribute to the country-specific recommendations and to the goals agreed by the Netherlands in Europe. Moreover, the Reform Programme is drafted too early on in the year to include spring decisions. Therefore, the government prefers to take up this recommendation by the Advisory Division in next year's Budget Memorandum. In it, the government will continue to work on integrating broad prosperity in the budget cycle, linking the requested analysis on policy coherence to this as much as possible. The analysis chapter can also be used for this purpose.
Yours sincerely,

the Minister of Finance,

Sigrid A.M. Kaag

The response from the government has not prompted the Advisory Division to change its assessment.

The Vice-President of the Council of State,

mr Th.C. de Graaf